

Message Text

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S E C R E T SECTION 1 OF 2 SEOUL 1571

EXDIS

C O R R E C T E D C O P Y (CORRECT TEXT PARAGRAPH 7.)

E. O. 11652: GDS
TAGS/ MASS, KS
SUBJECT: KOREA MODERNIZATION PROGRAM STUDY: ECONOMIC
ANALYSIS

REF: A. STATE 34897; B. SEOUL A-78

SUMMARY: THE ADDITIONAL KOREAN MILITARY EXPENDITURES
POSTULATED IN SUBJECT STUDY FOR 1973-78 CAN BE ABSORBED
BY ROKG WITHOUT SIGNIFICANT EFFECT ON ITS VERY HIGH
GROWTH RATE OR ITS IMPROVING DEBT SERVICE POSITION.

1. THE FOLLOWING ECONOMIC ANALYSIS, MADE IN RESPONSE
TO PARA 3, REF A, USES SAME METHODOLOGY USED IN EARLIER
ESTIMATIONS OF IMPACT OF ADDITIONAL ROKG MILITARY
EXPENDITURES. IT ALSO USES LATEST KOREAN ECONOMIC
PLANNING FORECAST FOR 1972-81, REPORTED REF B, WHICH
IS CONSIDERED GENERALLY REASONABLE EXCEPT FOR RATHER
MINOR ARBITRARY DIFFERENCES IN REAL GNP GROWTH RATES:
9.5 PCT FOR 1973, 9.0 PCT FOR 1974-76 AND 11.0 PCT FOR 1977-81.
DETAILED TABLES FOR FOREIGN EXCHANGE MILITARY
EXPENDITURES AND ESTIMATED DEBT SERVICE THROUGH
1978 BEING POUCED HOWARD NEWSOM, STATE EA/ K.

2. ECONOMIC PROSPECTS: CONTINUED RAPID GROWTH AND REDUCED
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DEPENDENCE ON FOREIGN CONCESSIONAL AID ARE FORESEEN FOR 1973-78. AFTER A DOMESTIC SLOWDOWN IN 1972, GROWTH IN GNP IS EXPECTED TO RESUME AT 9-10 PCT ANNUAL AVERAGE OF PAST TEN YEARS. GROWTH WILL CONTINUE TO DEPND PRIMARILY ON RAPID EXPORT EXPANSION, FOR WHICH PROSPECTS ARE GENERALLY GOOD. DEPENDENCE ON FOREIGN CREDITS AND ECONOMIC AID, EXPRESSED AS A PERCENT OF FIXED INVESTMENT, IS PROJECTED TO DECLINE FROM ABOUT 31 PCT IN 1973 TO 10 PCT IN 1978. AID IN THE AMOUNTS ASSUMED (\$500 MILLION P. A. IN PUBLIC LOANS THROUGH 1975, THEN DELINING) APPEARS VERY LIKELY TO BE AVAILABLE. IN ANY CASE, WE JUDGE KOREA HAS CAPACITY TO INCREASE DOMESTIC SAVING SO AS TO OFFSET ANY LIKELY AID SHORTFALL WITHOUT ANY SIGNIFICANT EFFECT ON ITS VERY HIGH RATE OF GROWTH.

3. KOREA'S BALANCE OF PAYMENTS AND DEBT SERVICE POSITION IMPROVED GREATLY IN 1972. DUE MAINLY TO A 38 PCT INCREASE IN FOREIGN EXCHANGE EARNINGS, DEBT SERVICE RATIO FELL FROM 19.9 PCT TO 17.7 PCT. ON BASIS OF LATEST ROKG EXPORT PROJECTIONS, WE ESTIMATE THIS RATIO WILL DECLINE TO ONLY ABOUT 10-12 PCT BY 1978.

4. TOTAL DEFENSE BURDEN: AS A PERCENT OF GNP, KOREA'S DEFENSE BURDEN HAS BEEN BELOW THAT OF SIMILAR DEVELOPING COUNTRIES IN RECENT YEARS. IT AVERAGED 4.1 PCT IN 1967-70, ROSE TO 4.4 PCT IN 1971 AND 4.5 PCT IN 1972 BUT IS BUDGETED TO FALL TO 4.2 PCT IN 1973. BASED ON ROKG GNP PROJECTIONS REPORTED REF B AND CONTINUED LOW DEFENSE ALLOCATION OF ONLY 4.2 PCT, DEFENSE BUDGET IN CURRENT DOLLARS CAN BE FORECAST TO INCREASE FROM \$462 MILLION IN 1973, TO \$946 MILLION IN 1978. FOR 1976, ESTIMATE IS \$696 MILLION, WHICH IS HIGHER THAN MAXIMUM FORESEEABLE EXPENDITURE REQUIREMENTS OF \$663 MILLION: AN ESTIMATED \$619 MILLION FOR REGULAR DEFENSE NEEDS PLUS \$44 MILLION FOR MAP DEPOSIT AND SERVICE OF FMS CREDITS. REGULAR DEFENSE NEEDS FOR 1976 ESTIMATED ON BASIS OF 1973 ROKG DEFENSE BUDGET PLUS PLANNED 1973 MAP FOR O& M, WITH PROVISION FOR ANNUAL INFLATION AND SUPPORT COSTS OF NEW EQUIPMENT. ANY ADDITIONAL NEEDS COULD BE MET BY INCREASING THE DEFENSE BURDEN RELATIVE TO OTHER SIMILAR COUNTRIES, E. G., ESTIMATED 1967-70 AVERAGED OF 16 PCT FOR NORTH KOREA, 9 PCT FOR TAIWAN, 7 PCT FOR IRAN AND NEARLY 5 PCT FOR TURKEY. A KOREAN INCREASE TO 5 PCT OF GNP IN 1976 WOULD

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GENERATE AN ADDITIONAL \$131 MILLION. SUCH AN INCREASE

COULD BE ACCOMPLISHED BY A SHIFT FROM PRIVATE TO GOVERNMENT CONSUMPTION, WITHOUT EFFECT ON GROWTH EXCEPT FOR POSSIBLE MINOR ADDITIONAL FOREIGN EXCHANGE COSTS.

5. FOREIGN EXCHANGE REQUIREMENTS: SINCE ROK DEFENSE BUDGETS DO NOT YET ABSORB SIGNIFICANT QUANTITIES OF INVESTMENT- TYPE RESOURCES FROM THE DOMESTIC ECONOMY, PRIMARY IMPACT OF ADDITIONAL EXPENDITURES ON ECONOMIC GROWTH IN NEAR TERM ARISES FROM UNANTICIPATED ANNUAL DIVERSSIONS OF FOREIGN EXCHANGE AWAY FROM POTENTIAL INVESTMENT IMPORTS.

6. MAXIMUM ADDITIONAL ANNUAL REQUIREMENT OF FOREIGN EXCHANGE FOR DEFENSE IS ESTIMATED AT \$7 MILLION IN 1973 , RISING TO \$60 MILLION IN 1978, AS SHOW IN FOLLOWING CY TABLE:

ESTIMATED ROKG FOREIGN EXCHANGE REQUIREMENTS FOR DEFENSE (\$ MILLION)

	1973	1974	1975	1976	1977	1978
O& M REQUIREMENTS (MAXIMUM, NET OF MAP)		25	32	36	48	48
FMS DEBT SERVICE & 10 PCT MAP	7	20	29	44	45	51
TOTAL	32	52	65	92	93	99

LESS: EST. FX BUDGET
PROVISION -25 -32 -36 -45 -40 -39

INCREMENTAL FX BURDEN
ON ROK 7 20 29 47 53 60

7. OPERATING - MAINTENANCE (O& M) REQUIREMENTS CONSIST PRIMARILY OF DIRECT FOREIGN EXCHANGE SUPPORT COSTS FOR EXISTING FORCE STRUCTURE, NET OF MAP FOR O& M WHICH IS ASSUMED TO DECLINE TO NEAR ZERO IN 1976 FROM ROUGHLY \$50 MILLION IN 1973, OF WHICH AN ESTIMATED \$35 MILLION COVERS FOREIGN EXCHANGE REQUIREMENTS. IN 1976-78, KOREA'S INCREASING DOMESTIC PRODUCTION CAPABILITY TO MEET DEFENSE

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MATERIAL REQUIREMENTS SHOULD RESULT IN A LEVELING OFF OF TOTAL O& M FOREIGN EXCHANGE REQUIREMENTS. ESTIMATED O& M FUNDING REQUIREMENTS SHOWN SHOULD BE CONSIDERED AS PROBABLE MAXIMUMS; ROKG FOREIGN EXCHANGE FUNDING SHORTFALLS FOR O& M OVER PAST THREE YEARS SUGGEST THAT UNDERFUNDING

DURING 1973-78 MAY RANGE BETWEEN \$10-15 MILLION ANNUALLY.
THE 10 PCT MAP DEPOSITS (ROKG WON PAYMENTS TO U. S. ARE
EQUIVALENT TO DOLLARS DUE TO U. S. NEED TO PURCHASE WON)
ARE PROJECTED TO FALL OFF AFTER REACHING \$15 MILLION IN
1974, 1975 AND 1976. SERVICING OF FMS CREDITS COVERS EXISTING
PROGRAMS PLUS PROJECTED NEW PROGRAMS OF \$20 MILLION IN
1974 AND \$70-85 MILLION ANNUALLY IN 1975-78.

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ACTION SS-25

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S E C R E T SECTION 2 OF 2 SEOUL 1571

EXDIS

E. O. 11652: GDS
TAGS: MASS, KS
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ANALYSIS

8. 1973 FOREIGN EXCHANGE BUDGET ALLOCATES \$25 MILLION
FOR DEFENSE AND MAP DEPOSIT NEEDS. ROKG ALLOCATION OF
FOREIGN EXCHANGE FOR DEFENSE WITHIN ITS OVERALL PLANNING
FRAMEWORK IS PROJECTED TO RISE TO ABOUT 40-45 MILLION IN
1976-78. SINCE FOREIGN EXCHANGE FOR DEFENSE IS ALREADY
BUILT INTO PLANNED ECONOMIC GROWTH TARGETS, THE ONLY
FOREIGN EXCHANGE FOR DEFENSE WHICH COULD NEGATIVELY
AFFECT PLANNED ECONOMIC GROWTH IS DIFFERENCE BETWEEN
THESE ANNUAL PROVISIONS AND CORRESPONDING ESTIMATED
REQUIREMENTS-- SHOWN AS BOTTOM LINE ON ABOVE TABLE.

9. IMPACT ON GROWTH: THESE ADDITIONAL FOREIGN EXCHANGE
COSTS WOULD HAVE LITTLE EFFECT ON GROWTH DUE TO THEIR

SMALLNESS RELATIVE TO PROBABLE KOREAN ECONOMIC N- PLUS MAGNITUDES. FOR EXAMPLE, THE MAXIMUM ADDITIONAL BURDEN DESCRIBED ABOVE (\$60 MILLION FOR 1978) WOULD BE ONLY 1.1 PCT OF PROJECTED FIXED INVESTMENT AND 0.8 PCT OF TOTAL IMPORTS IN 1978. EVEN ASSUMING MAXIMUM POSSIBLE IMPACT ON INVESTMENT, GNP GROWTH RATE WOULD BE REDUCED (WITH A TWO- YEAR LAG) FROM TENTATIVE ROKG PROJECTION OF 11.0 PCT IN 1980 TO 10.9 PCT (USING SAME METHODOLOGY WHICH YIELDED SIMILAR RESULTS IN EARLIER ESTIMATIONS). EFFECT IN OTHER YEARS FROM THE

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SMALLER ADDITIONAL EXCHANGE BURDENS ESTIMATED WOULD BE EVEN LESS.

10. IMPACT ON DEBT SERVICE: THE ADDITIONAL FMS BORROWING HERE CONSIDERED WOULD HAVE NO SIGNIFICANT EFFECT ON KOREA'S DEBT SERVICE POSITION. ADDITION OF \$39 MILLION IN SERVICE OF NEW FMS CREDITS IN 1978 WOULD RAISE DEBT SERVICE RATIO FROM 10.9 TO 11.4 PCT OF FOREIGN EXCHANGE EARNINGS, LEAVING IT WELL BELOW BOTH CURRENT RATIO AND " POTENTIAL DANGER" LEVEL OF 20 PCT. SERVICE OF THE \$325 MILLION IN NEW FMS CREDITS ASSUMED FOR 1974-78 WOULD INCREASE TO MAXIMUM OF \$52 MILLION IN 1979 AND THEN DECLINE.

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